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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 4

**Additional Registration and Other Regulatory Relief for Commodity Pool Operators and
Commodity Trading Advisors; Past Performance Issues**

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is amending Rule 4.5, which provides an exclusion from the definition of the term “commodity pool operator” (CPO) for certain persons, and Rules 4.13 and 4.14, which provide exemption from CPO and commodity trading advisor (CTA) registration, respectively, for certain other persons, so as to expand the availability of the relief provided by these rules. These amendments to Rules 4.5, 4.13 and 4.14 supercede the no-action relief the Commission previously issued with respect to the trading criteria of Rule 4.5 for certain persons and the need to register as a CPO or CTA for certain other persons. The Commission also is amending Rules 4.21, 4.22 and 4.31 to facilitate communications by CPOs and CTAs, by (1) permitting certain communications prior to Disclosure Document delivery; (2) relieving CPOs from duplicative disclosure and reporting requirements in the “master/feeder fund” context; (3) permitting CPOs to distribute Account Statements and Annual Reports electronically; (4) permitting CPOs to use facsimile signatures on Account Statements and Annual Reports; and (5) conforming the various signature requirements of Part 4. Further, the Commission is addressing certain issues related to the calculation and presentation of past performance by CPOs and CTAs under Rule 4.35 not addressed in the recent final rulemaking on CPO and CTA past performance.

DATES: Effective immediately for Rules 4.5, 4.7, 4.12, 4.13, 4.14, 4.21, 4.22 and 4.31; **[insert date 30 days after date of publication in the Federal Register]** for Rule 4.35.

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I. Background on the Proposal for Additional Registration and Other Regulatory Relief for CPOs and CTAs

A. Statutory and Regulatory Authorities

Section 1a(5) of the Commodity Exchange Act (Act) defines the term “commodity pool operator” to mean:

[A]ny person engaged in a business that is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility, . . .¹

¹ 7 U.S.C. 1a(5) (2000). Section 1a(5) also provides the Commission with authority to exclude persons from the CPO definition.

Commission Rule 4.10(d)(1) correspondingly defines the term “pool” to mean “any investment trust, syndicate or similar form of enterprise operated for the purpose of trading

Section 4m(1) of the Act² provides, in relevant part, that it is unlawful for any CPO, “unless registered under [the Act], to make use of the mails or any means or instrumentality of interstate commerce” in connection with its business as a CPO. Rules 4.5 and 4.13, provide exemptions from CPO registration.

Section 1a(6)(A) of the Act defines the term “commodity trading advisor” to mean any person who:

(i) for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value of or the advisability of trading in

—

(I) any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market or derivatives transaction execution facility;

(II) any commodity option authorized under section 6c of this title; or

(III) any leverage transaction authorized under section 23 of this title; or

(ii) For compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i).³

commodity interests.” Unless otherwise noted, Commission rules cited to herein are found at 17 CFR Ch. I (2003). Both the Act and the Commission’s rules issued thereunder can be accessed through the Commission’s web site, at: <http://www.cftc.gov/cftc/cftclawreg.htm>.

CFTC Staff Letters issued since 1995 may be accessed through <http://www.cftc.gov/opaletters.htm>.

² 7 U.S.C. 6m(1) (2000).

³ 7 U.S.C. 1a(6)(A) (2000).

Section 4m(1) of the Act also requires CTAs to register as such with the Commission and, along with Section 4m(3) and Rule 4.14, provides exemption from CTA registration.

If a person is exempt from registration as a CPO or CTA, its associated persons (APs) are not required to register as such. Further, neither the exempt CPO or CTA, nor any of its APs, is required to become a member of a registered futures association.

Generally, CPOs and CTAs who are, or who are required to be, registered with the Commission, must provide prospective pool participants or advisory clients, as the case may be, with a Disclosure Document containing specified information⁴ – e.g., the business background of the CPO or CTA and its principals, past performance, fees and other expenses, and conflicts of interest – and they must make and keep specified books and records.⁵ These CPOs also must provide unaudited periodic financial reports and certified annual reports to participants in their pools.⁶ Additionally, regardless of registration status, all persons who come within the CPO or CTA definition are subject to certain operational⁷ and advertising requirements⁸ under Part 4, to

Section 1a(6) also excludes certain persons not at issue here from the CTA definition, and provides the Commission with authority to exclude additional persons from that definition.

⁴ Rule 4.21 for CPOs and Rule 4.31 for CTAs.

⁵ Rule 4.23 for CPOs and Rule 4.33 for CTAs.

⁶ Rule 4.22.

⁷ Rule 4.20 for CPOs and Rule 4.30 for CTAs.

⁸ Rule 4.41.

all other provisions of the Act and the Commission's rules prohibiting fraud that apply to CPOs and CTAs, and to all other relevant provisions of the Act and the Commission's rules that apply to all commodity interest market participants, such as the general antifraud provisions, prohibitions on manipulation and the trade reporting requirements.

B. The Proposal

On March 17, 2003, the Commission published proposed revisions to Rules 4.5, 4.13, and 4.14 and various other rules under Part 4 of its regulations (Proposal).⁹ The Commission based the Proposal on a prior Rule 4.5 proposal;¹⁰ an Advance Notice of Proposed Rulemaking (ANPR) setting forth additional CPO and CTA registration exemptions submitted by the National Futures Association (NFA) and an additional CPO registration exemption submitted by the Managed Funds Association (MFA);¹¹ the Commission's Roundtable on CPO and CTA

While Rules 4.7 and 4.12(b) provide relief for certain registered CPOs from the Disclosure Document, periodic and annual reporting, and recordkeeping requirements of Rules 4.21, 4.22, and 4.23, they do not affect the applicability of Rules 4.20 and 4.41 to these CPOs. Similarly, CTAs who have claimed relief under Rule 4.7 continue to remain subject to Rules 4.30 and 4.41.

⁹ 68 FR 12622. The Proposal may be accessed through <http://www.cftc.gov/foia/fedreg03/foi030317b.htm>.

¹⁰ 67 FR 65743 (Oct. 28, 2002). Both the prior Rule 4.5 proposal and the comment letters the Commission received thereon may be accessed through <http://www.cftc.gov/foia/fedreg02/foi021028a.htm>.

¹¹ 67 FR 68785 (Nov. 13, 2002). Both the ANPR and the comment letters the Commission received thereon may be accessed through <http://www.cftc.gov/foia/fedreg02/foi021113a.htm>.

Issues (Roundtable);¹² and generally on its staff's experience in administering Part 4 of the regulations (Part 4 Rules).

Specifically, the Commission proposed to amend: (1) Rule 4.5, by deleting from the rule any trading criteria and corresponding disclosure requirement for eligibility for an exclusion from the CPO definition; (2) Rule 4.13, by expanding the availability of existing relief from CPO registration and providing for additional CPO registration exemptions thereunder; (3) Rule 4.14, similarly by expanding the availability of existing relief from CTA registration and providing for additional CTA registration exemptions thereunder; (4) Rules 4.21 and 4.31, by permitting certain communications with prospective pool participants and managed account clients, respectively, prior to Disclosure Document delivery; (5) Rules 4.21 and 4.22, by removing duplicative disclosure and reporting requirements in the "master/feeder fund" context; (6) Rule 4.22, by providing for electronic distribution of Account Statements and Annual Reports; and (7) Rules 4.7, 4.12, 4.13 and 4.22, by conforming the various signature requirements thereof.¹³

In announcing the Proposal, the Commission stated:

The relief the Commission is proposing today is consistent with the purpose and intent of the CFMA [Commodity Futures Modernization Act of 2000], and with the input the Commission has received in connection with its prior initiatives. . . . Accordingly, it is intended to allow greater flexibility and innovation, and to take into account market developments and the current investment environment, by modernizing the requirements for determining who should be excluded from the CPO definition,

¹² See 68 FR 12622, 12624-25 for a discussion of the origin and outcome of the Roundtable. Comments received in connection with the Roundtable may be accessed through <http://www.cftc.gov/opa/press02/opa4700-02.htm>.

¹³ See 68 FR 12622, 12625-30.

and who should remain within the CPO and CTA definitions but be exempt from registration. Thus, this relief is intended to encourage and facilitate participation in the commodity interest markets by additional collective investment vehicles and their advisers, with the added benefit to all market participants of increased liquidity.¹⁴

In connection with issuing the Proposal, the Commission also provided temporary no-action relief to Rule 4.5 eligible persons and CPOs and CTAs who met the trading and other criteria specified therein (Temporary No-Action Relief).¹⁵ The Proposal required that the Temporary No-Action Relief be claimed by filing a notice with the Commission. The effect of this final rulemaking on claimants under the Temporary No-Action Relief is discussed below.¹⁶

C. The Comments on the Proposal

The Commission received thirty-one comment letters on the Proposal, as follows: six from registered CPOs and CTAs; two from registered introducing brokers; two from registered securities investment advisers; one from a registered futures association; one from a futures industry trade association; two from securities industry trade associations; nine from law firms; one from a bar association; one from a certified public accounting firm; and six from retail investors. The majority of these commenters voiced strong support for the Proposal, by such statements as that it would fulfill the Commission's express purposes in making the Proposal, would better harmonize CFTC and Securities and Exchange Commission (SEC) regulation of

¹⁴ 68 FR 12622, 12625.

¹⁵ See 68 FR 12622, 12630-32.

¹⁶ See II.F.1. above.

investment management professionals, and would go a long way toward addressing the issues raised at the Roundtable.¹⁷

In light of these comments, the Commission generally is adopting the revisions to the Part 4 Rules that it proposed. Where the Commission is making a change from the Proposal, it discusses the change below.¹⁸ In the Federal Register release announcing the Proposal (Proposing Release), the Commission gave a detailed explanation of each rule amendment it had proposed to make.¹⁹ Accordingly, the scope of this Federal Register release generally is restricted to the comments received on the Proposal and to the changes to, and clarifications of, the Proposal that the Commission is making in response thereto. The Commission encourages interested persons to read the Proposing Release for a fuller discussion of the purpose of each of the amendments contained in the Proposal.

D. Significant Changes from the Proposal

¹⁷ The six retail investors submitted nearly identical letters, each of which stated in general terms that the Commission should do more rather than less to protect investors, and that hedge funds should be subject to “full and fair” disclosure standards. These letters did not, however, refer to any specific proposed rule or any of the Commission’s specific requests for comments. One of the other commenters on the Proposal suggested changes to Rules 4.5 and 4.13 that would have made the relief thereunder available to additional types of pension plan entities. This suggestion is outside the scope of this rulemaking. Accordingly, the Commission intends to consider the merits of the application of Rule 4.5 or 4.13 to any such plan on a case-by-case basis. (However, some of those plans are now covered by the rules the Commission is publishing today. See, e.g., Rule 4.14(a)(8)(i)(C)(2).)

¹⁸ In addition, the Commission is adopting certain clarifying amendments to Rule 4.7, such that Rule 4.7(a)(2)(vi) now refers to section 2(a)(51)(A) of the Investment Company Act of 1940 and Rule 4.7(a)(3)(viii) now includes “a limited liability company or similar business venture.” Also, to clarify the availability of Rule 4.13(a)(2), the Commission is employing the term “participant” in lieu of the term “person” in Rule 4.13(a)(2)(iii).

¹⁹ Supra n.13.

The significant changes from the Proposal that the Commission is making in the rules it is adopting today are as follows: (1) Rule 4.5 no longer contains a “marketing” restriction, but it does require disclosure of the fact, and effect, of a claim for exclusion from the CPO definition; (2) Rule 4.13(a)(3) expands the trading limit criterion thereunder to “5 percent” and “100 percent,” from the proposed “2 percent” and “50 percent” limits; (3) Rule 4.13(a)(3) expands the investor eligibility criterion thereunder to “knowledgeable employees” and certain other persons, in addition to “accredited investors,” as proposed; and (4) Rule 4.22 now provides for electronic distribution of Annual Reports, in addition to Account Statements, as proposed, where a CPO furnishes a one-way disclosure notice and the pool participant does not timely object to such distribution.

In addition, the Commission is clarifying: (1) the meaning of the term “aggregate net notional value” in Rule 4.13(a)(3); (2) the effect of this final rulemaking on the Temporary No-Action Relief; (3) the applicability of the Annual Report requirement to CPOs who withdraw from registration in reliance upon Rule 4.13(a)(3) or (a)(4); and (4) in new Appendix A to Part 4, the application of the Rule 4.13(a)(3) trading limit criteria to a broad range of fund-of-fund situations.

II. Responses to the Comments

A. Amendment to Rule 4.5: Deleting Trading and “No Marketing” Criteria for Exclusion from the CPO Definition

The Commission proposed to amend the operating criteria of Rule 4.5 by deleting therefrom provisions concerning commodity interest trading restrictions and related

disclosures.²⁰ The Commission explained that the operating criteria of the rule would continue to include the “no marketing” and submission to special calls requirements. The Commission reasoned that “it is appropriate to maintain the marketing restriction because, unlike the case with the proposed CPO registration exemption, members of the retail public may participate in the trading vehicles subject to Rule 4.5.”²¹ The Commission nonetheless requested comment on the merits of retaining the “no marketing” criterion – i.e., that a Rule 4.5 qualifying entity “will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets.”

In response to this request, one commenter agreed with the proposed retention of the “no marketing” criterion (and with the Commission’s rationale therefore) but several commenters disagreed with it. This latter group supported its position with claims that, in the absence of any trading restriction, the “otherwise regulated” nature of the qualifying entities specified in Rule 4.5 would provide adequate customer protection, and, further, that compliance with the subjective nature of the marketing restriction could give rise to the possibility of unequal enforcement where commodity interest trading was restricted.

In light of these comments, the Commission is amending Rule 4.5 such that it no longer contains any restrictions relating either to commodity interest trading or to marketing of the entity. The rule does, however, continue to require disclosure to investors – now, that the qualifying entity’s operator has claimed exclusion from the CPO definition, and that therefore the person is not subject to CPO registration and regulation under the Act. This requirement is

²⁰ See 68 FR 12622, 12625-26.

²¹ 68 FR 12622, 12626.

set forth in paragraph (c)(2)(i) of the amended rule. The Commission did not propose to change the “special call” provision of Rule 4.5, and, accordingly, the rule continues to contain this provision, in paragraph (c)(2)(ii).²²

The disclosure requirement the Commission is adopting today may be satisfied in the same manner that the Commission previously established for the (albeit now deleted) disclosure of commodity interest trading limits under Rule 4.5 – i.e.,:

through inclusion of the specified information in any document which is required by the qualifying entity’s other Federal or State regulator to be routinely furnished to participants or, if no such document is required to be routinely furnished, through disclosure in any instrument that is required by the other regulator to establish the entity’s investment policies and objectives and which is required by such other regulator to be made available (but not specifically furnished) to the entity’s participants.²³

²² The special call provision previously was set forth in paragraph (c)(2)(iv) of Rule 4.5.

²³ 50 FR 15868, 15879 (Apr. 23, 1985).

The Commission further stated that it was aware that:

certain qualifying entities – e.g., registered investment companies – are required by their other regulators to make disclosures directly to their participants but that other qualifying entities – e.g., a commingled trust fund of a federally regulated bank – may not be subject to any such direct disclosure requirement. The Commission intends that those other entities may satisfy this representation by indirect disclosure. For example, in the case of a bank commingled trust fund that intends to trade commodity interests on behalf of the various trust accounts comprising the commingled fund, the bank only needs to make the disclosure representation to the trustee of each underlying trust account. Id., n.69.

At the request of other commenters, the Commission confirms that Rule 4.5 does not affect the ability of a person who has claimed an exclusion from the CPO definition thereunder: (1) to invest in any other trading vehicles – e.g., a commodity pool that engages in unlimited commodity interest trading; and (2) to qualify for an exemption from registration as a CPO under Rule 4.13 in connection with its operation of another trading vehicle that is not covered under Rule 4.5 – e.g., a trading vehicle that is not a registered investment company covered under Rule 4.5(b)(1) or a non-pool covered under Rule 4.5(a)(4). This latter confirmation is contained in new Rule 4.5(g), and new Rule 4.13(f) contains a reciprocal provision for CPOs claiming registration relief thereunder. Also, the Commission is discussing below the effect of this rulemaking generally on persons who previously have claimed relief under Rule 4.5.²⁴

The Commission did not propose, and is not now adopting, any other amendments to Rule 4.5. Thus, the proviso to Rule 4.5(c) continues to state that compliance with the operating criteria of the rule:

shall not be deemed a substitute for compliance with any criteria applicable to commodity futures or commodity options trading established by any regulator to which [an eligible] person or qualifying entity is established.

Moreover, eligible persons and qualifying entities remain subject to all relevant provisions of the Act and the Commission's rules that apply to all commodity interest market participants, such as

²⁴ See II.F.1.

the general antifraud rules, the prohibitions on manipulation and the trade reporting requirements.²⁵

B. Amendments to Rule 4.13: Adding CPO Registration Exemptions

1. Use of Terms Defined under the Federal Securities Laws

Various of the new CPO registration exemptions under Rule 4.13 that the Commission is adopting today base eligibility on pool participants coming within the meaning of a term that is defined under the federal securities laws – e.g., that of “accredited investor,” defined in Rule 501(a) under the Securities Act of 1933 (‘33 Act).²⁶ As requested by commenters, by this Federal Register release the Commission confirms that it intends to follow interpretations issued by the SEC and its staff of these definitions and in the event any of these definitions are amended, the Commission will utilize the revised definitions in the applicable Rule 4.13 exemption. However, as the Commission stated in connection with adopting revisions to Rule 4.7 that similarly base relief on certain of these terms:

The Commission has the right further to interpret or to amend Rule 4.7 to exclude from the [qualified eligible person definition] any person that the SEC or its staff found to be a QP or knowledgeable employee or to include in the [qualified eligible person definition] any person the SEC or its staff excluded from the QP or knowledgeable employee definition, if such action is found to be necessary to effectuate the purposes of the Act and the

²⁵ As stated in I. A. above, these provisions also apply to persons exempt from registration as a CPO or CTA.

²⁶ 17 CFR 230.501(a) (2003). Other such terms found in Rule 4.13 are “knowledgeable employee,” defined in the Investment Company of 1940 (ICA), 17 CFR 270.3c-5 (2003), and “qualified purchaser” (QP), defined in Section 2(a)(51)(A) of the ICA.

Commission's regulations. The Commission expects that it would exercise this right infrequently.²⁷

2. New Rule 4.13(a)(3): Adding an Exemption where Commodity Interest Trading is Limited and Pool Participants are Sophisticated

a. In General

The Commission proposed new Rule 4.13(a)(3) to provide an exemption from CPO registration where: (1) the pool a person operates engages in a limited amount of commodity interest trading – i.e., by committing no more than 2 percent of the liquidation value of the pool's portfolio to establish commodity interest trading positions, whether entered into for bona fide hedging purposes or otherwise, or where the aggregate net notional value of the pool's commodity interest trading does not exceed 50 percent of the pool's liquidation value; (2) the CPO reasonably believes that each investor in the pool is an "accredited investor"; and (3) the CPO does not market participations in the pool as or in a vehicle for trading in the commodity futures or commodity options markets.²⁸ After explaining how and why this proposal differed from the CPO registration exemption proposal submitted to the Commission by the National Futures Association (NFA) as set forth in the ANPR,²⁹ and after noting the comments received on the ANPR,³⁰ the Commission specifically requested comment on whether under the rule there should be: (1) a higher percentage of assets that may be committed to establish commodity

²⁷ 65 FR 47848, 47852 (Aug. 4, 2000).

²⁸ See 68 FR 12622, 12626-27.

²⁹ See 67 FR 68785, 68786-87.

³⁰ See 68 FR 12622, 12626-27.

interest positions; and (2) any greater ability to trade commodity interests for bona fide hedging purposes than for non-hedging purposes, including whether there should be any restriction whatsoever on trading for hedging purposes.

Many commenters provided input on proposed Rule 4.13(a)(3). Several of them stated that the proposed trading limits were too low, such that the exemption would be unavailable to many CPOs who should not be subject to the Commission's registration, disclosure, reporting and recordkeeping requirements. One of these commenters recommended that the rule treat bona fide hedging and non-hedging positions alike, claiming that this would simplify trading limit calculations under the rule by avoiding the need to determine whether a particular "risk management position" qualifies as a hedging position, but another commenter recommended that no trading limits should be applicable to the CPO of a pool that trades commodity interests solely for hedging purposes. Two commenters urged that the rule should permit a limited number of non-accredited investors, such as "knowledgeable employees." Commenters also requested clarification on the meaning of the term "aggregate net notional value"; on whether security futures products (SFPs) are included in the Rule 4.13(a)(3) trading limit tests; and on whether, to qualify for relief under Rule 4.13(a)(3), a CPO must operate its pool pursuant to an exemption from registration under the '33 Act, as a "privately-offered" pool.³¹

³¹ This is a requirement under Rule 4.13(a)(4) as proposed and as adopted.

One commenter stated that since the investor criteria of Rules 4.13(a)(3) and (a)(4) include, among other persons, certain "accredited investors," then it logically follows that the pool must be privately offered. That is the context in which the rules of the SEC (e.g., Regulation D under the '33 Act) employ the term "accredited investor."

In response to these comments, and in light of its own further deliberations on proposed Rule 4.13(a)(3), the Commission is making various changes from the Proposal in the final rule. Specifically, Rule 4.13(a)(3) as adopted requires: (1) that interests in the pool for which a CPO is seeking to claim relief thereunder must be exempt from registration under the '33 Act and may not be marketed to the public in the United States (U.S.) (paragraph (a)(3)(i)); (2) that the pool may not commit more than 5 percent of assets to establish commodity interest positions or have a notional value of its commodity interest positions that exceeds 100 percent of the pool's liquidation value (paragraphs (a)(3)(ii)(A) and (a)(3)(ii)(B), respectively);³² and (3) that the pool may include, as proposed, participants who are "accredited investors," and in addition, certain family trusts formed by accredited investors; "knowledgeable employees;" and persons who are QEPs under Rule 4.7(a)(2)(viii)(A) (paragraph (a)(3)(iii)).³³

Further, Rule 4.13(a)(3) as adopted now clarifies that: (1) at all times the pool must meet one or the other of the specified trading limits (paragraph (a)(3)(ii)); (2) security futures products are included in each test (paragraph (a)(3)(ii)); (3) the notional value of an option contract must reflect an adjustment for the delta of the contract (paragraph (a)(3)(ii)(B)(1)); and (4) contracts may be netted by underlying commodity and across designated contract markets, registered derivatives transaction execution facilities and foreign boards of trade (paragraph (a)(3)(ii)(B)(2)).

³² Thus, the rule continues to include both hedging and non-hedging positions in the calculation of either test.

³³ As proposed and as adopted, Rule 4.13(a)(3) also generally prohibits the CPO from marketing participations in the pool "as or in a vehicle for trading in the commodity futures or commodity options markets."

b. New Appendix A to Part 4: “Fund-of-Funds”

Most of the commenters on proposed Rule 4.13(a)(3), and in fact, on the Proposal as a whole, expressed concern over the application of the Rule 4.13(a)(3) trading limits in the “fund-of-funds” context.³⁴ They requested the Commission to confirm in its final rulemaking statements it had made in the Proposal on this issue.³⁵ They also presented numerous scenarios involving “fund-of-funds” structures for the Commission to consider.

To address these concerns, the Commission is adopting today Appendix A to Part 4. The introductory text explains that:

The following provides guidance on the application of the trading limits of Rule 4.13(a)(3)(ii) to commodity pool operators (CPOs) who operate “fund-of-funds.” For the purpose of this Appendix A, it is presumed that the investor fund CPO can comply with all of the other requirements of Rule 4.13(a)(3). It also is presumed that where the investor fund CPO is relying on its own computations, the investor fund is participating in each investee fund that trades commodity interests as a passive investor, with limited liability (e.g., as a limited partner of a limited partnership or a non-managing member of a limited liability company). Fund-of-fund CPOs who seek to claim exemption from registration under Rule 4.13(a)(1), (a)(2) or (a)(4) may do so without regard to the trading engaged in by an investee fund, because none of the registration exemptions set forth in those rules concerns limits on or levels of commodity interest trading. Persons whose fact situations do not fit any of the scenarios below should contact Commission staff to discuss the applicability of the registration exemption in Rule 4.13(a)(3) to their particular situations.

³⁴ In the ANPR, the Commission defined a “fund-of-funds” as an investor fund that indirectly trades commodity interests through participation in one or more investee funds that directly trades commodity interests. See 67 FR 68785, 68788, n.15.

³⁵ See 68 FR 12622, 12631.

In adopting Appendix A, the Commission has been guided by the following principles, i.e., that relief under Rule 4.13(a)(3) should be available where:

(1) The CPO of each investee fund is either: (i) itself claiming exemption from CPO registration under Rule 4.13(a)(3); or (ii) a registered CPO that is complying with the trading restrictions of Rule 4.13(a)(3). In this regard, the CPO of the investor fund should be able to rely upon the representations of the investee fund CPOs to the foregoing effect.

(2) The CPO of an investor fund has actual knowledge of the trading and commodity interest positions of the investee funds (e.g., where the investee funds are operated by the CPO or one or more affiliates of the CPO). In this case the investor fund CPO may aggregate the commodity interest positions across the investee funds to determine compliance with the trading restrictions of Rule 4.13(a)(3).

(3) An investor fund does not trade commodity interests directly, and the CPO has allocated no more than 50 percent of the investor fund's assets to investee funds that trade commodity interests (regardless of the level of commodity interest trading engaged in by those investee pools). The investor fund CPO may claim exemption under Rule 4.13(a)(3) because the investor fund's exposure to the futures markets may be said to be comparable to that of a stand-alone pool that meets the aggregate net notional value test.

(4) An investor fund engages in direct commodity interest trading in addition to its allocation of assets to investee funds, provided the CPO treats the assets committed to direct trading as a separate pool with its own liquidation value and applies the trading restrictions of Rule 4.13(a)(3) to that "separate pool."

3. New Rule 4.13(a)(4): Adding an Exemption where Pool Participants are Highly Sophisticated

The Commission proposed new Rule 4.13(a)(4) to provide an exemption from CPO registration where: (1) interests in the pool for which the CPO seeks to claim relief (a) are exempt from registration under the Securities Act of 1933, and (b) are offered and sold without marketing in the United States (U.S.); and (2) the CPO reasonably believes that (a) natural person participants are QEPs under Rule 4.7(a)(2), and (b) non-natural person participants are QEPs under Rule 4.7 or “accredited investors.”³⁶ After explaining how and why this proposal differed from the CPO registration exemption proposal submitted to the Commission by the MFA, as set forth in the ANPR,³⁷ the Commission requested comment on what investor qualifications would be appropriate under proposed Rule 4.13(a)(4) and whether all natural person QEPs should be included for purposes of the rule.

The comments received in response to this request were mixed, with some stating that the proposed investor eligibility qualifications would be appropriate, yet others claiming that the proposal was unnecessarily restrictive and that the rule should include all natural person QEPs -- i.e., natural persons who are QEPs under either Rule 4.7(a)(2) or (a)(3). Inasmuch as Rule 4.13(a)(4) does not contain any trading limits whatsoever, and the operators in question are not “otherwise regulated”, the Commission is not persuaded by this latter set of comments and, accordingly, it is adopting the rule as proposed.

³⁶ See 68 FR 12622, 12627.

³⁷ See 67 FR 68785, 68787-88.

4. Alternative Proposal for Relief

As an alternative to the foregoing registration exemption proposals for certain CPOs, and to various registration exemption proposals for certain CTAs under Rule 4.14, the Commission sought comment on adoption of a notice registration scheme that would be comparable to the proposed exemption approach with respect to information required to be filed with the Commission and compliance with Part 4 requirements.³⁸ Specifically, the Commission asked for comment on whether a notice registration scheme could make it more clear to the public and other regulatory authorities that this group of CPOs and CTAs remained subject to the CFTC's jurisdiction under the Act, the Bank Secrecy Act and other statutes, while providing the same amount of regulatory relief as the proposed exemption.

The Commission received several comments in response to this request, each of which recommended that the Commission not adopt a notice registration scheme. The arguments advanced to the Commission were that such a scheme: (1) might confuse prospective pool participants into thinking that a notice registrant was subject to more oversight and regulation than it actually would be;³⁹ (2) was unnecessary because CPOs exempt from registration remain subject to CFTC jurisdiction, which includes the antifraud provisions of the Act and the Commission's rules; and (3) would not improve the information available to the Commission but, rather, would raise recordkeeping, supervision and audit requirement issues for all

³⁸ See 68 FR 12622, 12628.

³⁹ Cf. Rule 3.10(a)(3), which generally provides for notice registration as a futures commission merchant or introducing broker for certain brokers and dealers that are registered with the SEC, are members of a registered national securities association, and solely trade security futures products.

concerned. In light of these comments, the Commission is not adopting a notice registration scheme.

C. Amendments to Rule 4.14: Adding and Expanding CTA Registration Exemptions

1. New Rule 4.14(a)(8)(i)(D): Adding an Exemption where Advice is to Rules

4.13(a)(3) and (a)(4) Pools

As proposed and as adopted, new Rule 4.14(a)(8)(i)(D) provides CTA registration relief for advisors to commodity pools that meet the requirements of the new CPO registration exemptions based on, among other things, trading limits, as discussed above.⁴⁰ Several persons have asked whether the Commission intends that this CTA registration exemption will define the term “primarily” as used in Section 4m(3) of the Act,⁴¹ which also provides an exemption from CTA registration, for any CTA that –

is registered with the [SEC] as an investment adviser whose business does not consist primarily of acting as a [CTA] . . . and that does not act as a [CTA] to any investment trust, syndicate or similar form of enterprise that is engaged primarily in trading in any commodity for future delivery on or subject to the rules of any contract market or registered derivatives transaction execution facility. (Emphasis added.)

The Commission does not intend that the CTA registration exemption in Rule 4.14(a)(8)(i)(D) have any bearing whatsoever on the meaning of the term “primarily” in Section

⁴⁰ See the discussion of Rule 4.13(a)(3)(ii) in II. B. 2. above.

⁴¹ 7 U.S.C. 6m(3) (2000).

4m(3). Rather, the Commission intends to employ the criteria of Rule 4.14(a)(8)(i)(D) solely for the purposes of the rule itself.⁴²

2. New Rule 4.14(a)(10): Counting Legal Organizations as a Single “Person”

As the Commission explained in the Proposing Release, the single “persons” specified in Rule 4.14(a)(10) for the purposes of Section 4m(1) of the Act are patterned after the single “clients” specified in Rule 203(b)(3) under the IAA.⁴³ By this release, and at the request of a commenter, the Commission confirms that it intends to follow interpretations of Rule 203(b)(3) issued by the SEC and its staff. As stated above in connection with the discussion of Rules 4.13(a)(3) and 4.13(a)(4), however, the Commission has the right to provide its own interpretations concerning the counting of single “persons,” if such action is found to be necessary to effectuate the Act and the Commission’s regulations, and, further, the Commission expects that it would exercise this right infrequently.⁴⁴

⁴² The CFMA added Section 4m(3) to the Act and a corresponding Section 203(b)(6) to the Investment Advisers Act of 1940 (IAA), which provides an exemption from registration for:

any investment adviser that is registered with the [CFTC] as a [CTA] whose business does not consist primarily of acting as an investment adviser, . . . and that does not act as an investment adviser to –

(A) [a registered] investment company; or

(B) a company which has elected to be a business development company . . . and has not withdrawn its election.

⁴³ See 66 FR 12622, 12628-29.

⁴⁴ See II.B.1. above. The Commission also has clarified in Rule 4.14(a)(10) as adopted that the source of this exemption is Section 4m(1).

D. Amendments to Rules 4.21, 4.22 and 4.31

1. Amended Rules 4.21(a) and 4.31(a): Permitting Communications Prior to Disclosure

Document Delivery

Commission Rules 4.21 and 4.31 respectively require CPOs and CTAs to provide a Disclosure Document to their prospective pool participants and advisory clients. The Commission proposed to amend these rules to provide that the Disclosure Document must be delivered by no later than the time a CPO delivers a subscription agreement for the pool for which it is soliciting or a CTA delivers an advisory agreement for the trading program for which it is soliciting.⁴⁵ To ensure achievement of the purpose of the Disclosure Document – i.e., that prospective investors are fully informed about all material facts before committing their funds –, and consistent with the Roundtable comments, these proposed rule amendments would have been subject to the proviso that “any material distributed in advance of the delivery of the Disclosure Document is consistent with or amended by the information contained in the Disclosure Document and with the obligations of the [CPO or CTA] under the Act, the

Compare CFTC v. Savage, 611 Fed. 270 (9th Cir. 1979). There, the Court held that Section 4m(1) includes “within the persons to whom an advisor ‘furnishes’ advice customers of an advisee when the advisor knows or should know that advice he gives is directly passed to those customers.” Id. at 280. The advisee in Savage was a corporation – i.e., a legal organization – that was registered as a futures commission merchant with the Commission. Rule 4.14(a)(10) counts a legal organization as a single “person” where the organization is receiving commodity interest trading advice based on its investment objectives. Inasmuch as the advisee in Savage was not receiving advice based on its investment objectives but, rather, as a mere conduit for others to receive advice, it would not be counted as a single “person” under Rule 4.10(d).

⁴⁵ See 68 FR 12622, 12629.

Commission's regulations issued thereunder, and the laws of any other applicable federal or state authority." (Emphasis added.)

One of the commenters on these proposed rule amendments objected to this proviso, claiming that the phrase "or amended by" could be read to mean that information does not have to be consistent with the Disclosure Document at the time the information is distributed, as long as it is corrected when the Disclosure Document is delivered. To avoid any such misunderstanding, Rules 4.21(a) and 4.31(a) as adopted now further provide that:

In the event such previously distributed information is amended by the Disclosure Document in any material respect, the prospective participant must be in receipt of the Disclosure Document at least 48 hours prior to its [subscription or advisory agreement, as the case may be] being accepted.

Another commenter on these proposed rule amendments asked for clarification on the permissibility of distributing performance materials in advance of delivery of a Disclosure Document. In response, the Commission states that performance information may be distributed in advance of the Disclosure Document, provided it is presented in the format specified by the CFTC.⁴⁶

In connection with adopting these amendments to Rules 4.21 and 4.31, the Commission has reviewed its July 1997 interpretation regarding electronic delivery of CPO and CTA

⁴⁶ See, e.g., Rules 4.25 and 4.35, which establish performance disclosure formats for CPOs and CTAs, respectively; Rule 4.41, which concerns advertising by CPOs, CTAs and their principals; and 46 FR 26004, 26012 (May 8, 1981), wherein the Commission provided guidance on the advertising of past performance results. See also, Rule 156 under the '33 Act, 17 CFR 230.156 (2003), which sets forth what the SEC would consider "materially misleading" in the context of investment company sales literature.

Disclosure Documents (the “1997 Interpretation”)⁴⁷ for the purpose of considering whether it should revise certain aspects of that interpretation, such as the requirement that visitors to a CPO or CTA website must view a summary risk disclosure statement before they may access performance information. The Commission notes that the 1997 Interpretation was premised on the now obsolete requirement in Rules 4.21 and 4.31 that a Disclosure Document respectively be delivered on or before the date that a CPO solicited, accepted or received funds or other property from a prospective pool participant, or a CTA solicited or entered into an advisory agreement with a prospective client. Accordingly, the provisions of amended Rules 4.21 and 4.31 supercede the 1997 Interpretation.

2. New Rule 4.22(i): Distributing Account Statements and Annual Reports

Electronically

The Commission is amending Rule 4.22 by adding a new paragraph (i) to the rule to establish that, as proposed, a CPO may distribute periodic Account Statements to pool participants by electronic means, and, in response to favorable comments, a CPO may so distribute Annual Reports.⁴⁸ Also in response to comments, for greater flexibility the rule as adopted does not specify each and every step a CPO must take to furnish financial information to

⁴⁷ See, “Interpretation Regarding Use of Electronic Media by Commodity Pool Operators and Commodity Trading Advisors for Delivery of Disclosure Documents and Other Materials,” 62 FR 39104 (July 22, 1997). In that interpretation, the Commission made provision for delivery of required Disclosure Documents in the context of, for example, CPO and CTA Internet websites by requiring that a summary risk disclosure be given along with a hyperlink or other comparable ready access to the full Disclosure Document, in lieu of requiring that the CPO or CTA make a website viewer scroll through the entire Disclosure Document before viewing any material that might constitute a solicitation by the CPO or CTA.

⁴⁸ See 68 FR 12622, 12629-30.

pool participants. What the rule does require is that prior to transmission of any Account Statement or Annual Report to a pool participant by means of electronic media, a CPO must disclose to the participant that it intends to distribute these documents electronically, absent objection from the participant, which objection, if any, the participant must make no later than 10 business days following its receipt of the disclosure.⁴⁹

E. Amendments to Rules 4.5, 4.7, 4.12, 4.13, 4.14 and 4.22: Conforming Signature Requirements

The Commission proposed to amend certain of the Part 4 rules that list the CPO and CTA signatories who may sign various required documents.⁵⁰ As the Commission explained:

Rules 4.7(d), 4.12(b), 4.13(b), and 4.22(h) provide that the documents required thereunder must be signed by a CPO or CTA as follows: if it is a sole proprietorship, by the sole proprietor; if a partnership, by a general partner; and if a corporation, by the chief executive officer or chief financial officer.

Upon review of this list of permitted signatories, the Commission believes that it may be unnecessarily restrictive in that it leaves no room for other organizational structures under which CPOs and CTAs operate – e.g., limited liability companies. Accordingly, the Commission is proposing to amend Rules 4.7(d), 4.12(b) and 4.13(b) to provide that the documents required thereunder must be signed by a duly authorized representative of the CPO or CTA. This would be consistent with existing signature requirements under Rules 4.5 and 4.14. * * * However, because the document required under Rule 4.22(h) pertains to the accuracy and completeness of certain financial reports (i.e., commodity pool Account Statements and Annual Reports), the

⁴⁹ In light of this action, the Commission may review the procedures in Rule 1.33 and 1.46 it previously adopted for electronic transmission of certain information by FCMs to their customers, with a view towards conforming them to new Rule 4.22(i).

⁵⁰ 68 FR 12622, 12630.

Commission specifically is proposing that this oath or affirmation be signed by a representative duly authorized to bind the pool operator.⁵¹

The Commission received two comments on these proposed rule amendments. The first comment recommended that the same standard be applied to each situation where documents are required to be executed. The Commission agrees with this comment, and, accordingly, is adopting as the suggested “universal standard” the requirement that Part 4 documents be manually executed by “a representative duly authorized to bind” an eligible person, CPO or CTA. Specifically, this requirement is now found in Rules 4.5(f)(2), 4.7(d)(1)(vii), 4.12(b)(3)(vi), 4.13(b)(1)(iii), 4.14(a)(8)(iii)(A)(3) and 4.22(h)(3).

The second comment recommended that the list of permitted signatories be expanded, such that the applicable rules would specifically provide that “any listed principal” is a permitted signatory. The Commission does not agree with this comment, because not all principals of a CPO or a CTA may in fact be duly authorized to bind the CPO or CTA.⁵²

F. Effect of Final Rulemaking

⁵¹ Id.

⁵² Rule 4.10(e)(1) provides that for the purposes of Part 4, the term “principal” has the same meaning as the term “principal” under Rule 3.1(a).

Rule 3.1(a) generally defines the term “principal” of an entity to include, among others, the following: executive officers; persons in charge of a function subject to Commission regulation; persons who have the power to exercise a controlling influence over the entity’s activities that are subject to Commission regulation; ten percent or greater shareholders; and persons who have contributed ten percent or more of the capital.

1. Effect on Prior Claimants

The amendments to Rules 4.5, 4.13 and 4.14 that the Commission is publishing today do not require a person who previously has claimed relief under Rule 4.5 or the Temporary No-Action Relief⁵³ to re-file its claim in order to maintain that relief or to trade in accordance with amended Rule 4.5, 4.13 or 4.14. Moreover, where the person continues to comply with the commodity interest trading limitations applicable to that previously claimed relief, it does not need to take any other action to take advantage of the exemptions being made available by these amendments.⁵⁴ The person nonetheless remains subject to all other applicable requirements of Rule 4.5, 4.13 or 4.14, as the case may be, to all other applicable provisions of the Act and the Commission's rules thereunder, and to any and all obligations under any other applicable Federal and State statutory and regulatory authorities that may result from its activities under these exemptions.

2. Effect of Withdrawal from CPO Registration on Rule 4.22(c) Annual Report Requirement

A CPO who has withdrawn from registration in order to claim the Temporary No-Action Relief or who withdraws from registration in order to claim relief under Rule 4.13(a)(3) or (a)(4) adopted today nonetheless remains subject to the Annual Report requirement of Rule 4.22(c), as has been the case with CPOs who have withdrawn from registration for any other reason. This is

⁵³ See 68 FR 12622, 12630-32.

⁵⁴ Thus, for example, a person who has claimed relief under Rule 4.5 or the Temporary No-Action Relief who continues to comply with the prior limits is not subject to the revised disclosure requirement of Rule 4.5(c)(2)(i) or Rule 4.13(a)(5), as the case may be.

because the Commission believes that when a CPO leaves direct CFTC oversight, the CPO's pool participants should get all of the information they are entitled to up to that time. The Commission nonetheless is aware that in past cases its staff has worked with withdrawing CPOs in appropriate cases to provide these persons with flexibility in complying with Rule 4.22(c). By this Federal Register release, the Commission instructs its staff to continue this practice.

G. Continued Availability of No-Action Relief from Commission Staff

The Commission is aware that, notwithstanding the rules it is adopting today, there may be persons that do not meet the criteria of Rule 4.5 for eligible persons, Section 4m(3) of the Act or Rule 4.13 for CPOs, or Section 4m(1) of the Act or Rule 4.14 for CTAs but, that, nonetheless, under their particular facts or circumstances, merit relief. The Commission also is aware that, in the past, its staff has provided no-action relief from the criteria of Rule 4.5 and from the registration requirement of Section 4m(1) of the Act on a case-by-case basis. Consistent with that practice, the Commission directs its staff to continue to issue such relief in appropriate cases.⁵⁵

III. Past Performance Presentation Issues

On March 13, 2003, the Commission published in the Federal Register⁵⁶ proposed rule amendments regarding the computation and presentation of rate of return information and other disclosures concerning past performance of accounts over which a CTA has had trading

⁵⁵ For example, under appropriate circumstances, it may be permissible for a person who seeks to claim an exemption from CPO registration under Rule 4.13(a)(3) to include contracts such as swaps when calculating the "aggregate net notional value" criterion of the rule.

⁵⁶ 68 FR 12001. The Performance Proposal and comments received may be accessed through http://www.cftc.gov/foia/comment03/foi03--004_1.htm.

authority (Performance Proposal). In the Performance Proposal, the Commission also sought comment on whether a core principle should replace detailed performance requirements. The Commission has adopted a core principle approach regarding presentation of partially funded accounts,⁵⁷ but noted in the release adopting the core principle that proposed changes relating to certain performance issues with application beyond the partially funded account situation would be addressed separately.⁵⁸ These issues include: (1) disclosure of the range of rates of return for closed accounts, or other measures of variability in returns experienced by clients for the offered trading program; (2) computation of program draw-down information on a composite basis; and (3) methods to account for the effect of intramonth additions and withdrawals in the computation of rate of return.

A. Range of Rates of Return for Closed Accounts

The Commission proposed to revise Rule 4.35(a)(1)(viii) to require that the performance capsule for the offered program include, in addition to the number of accounts closed with profits and the number closed with losses, the range of rates of return for the accounts closed with net lifetime profits and accounts closed with net lifetime losses, during the five-year period for which past performance must be disclosed.⁵⁹ The Commission based this proposal on its belief that such disclosure would provide important summary information on the variation in returns experienced by individual clients and would be useful to prospective clients considering participation in the CTA's program. Several commenters on the Performance Proposal

⁵⁷ 68 FR 42964 (July 21, 2003).

⁵⁸ Id. at 42966.

⁵⁹ See Rule 4.35(a)(5).

expressed the belief that this disclosure would not provide useful information to prospective clients, with one commenter noting that the requirement would increase the burden on CTAs without any corresponding benefit.

After consideration of these comments, the Commission has determined that the objective of the proposed change – to enhance the information available to prospective clients about the experience of the CTA’s prior clients – continues to be an important goal of the past performance reporting required under Commission rules. However, the Commission believes that it is appropriate to permit flexibility in the manner in which CTAs meet this objective. Accordingly, the Commission is amending Rule 4.35(a)(1)(viii) to require that the performance capsule include a measure of the variability of returns experienced by clients in the offered trading program who both opened and closed their accounts during the period for which performance is required to be disclosed, for accounts closed with positive net lifetime rates of return and for those closed with negative net lifetime rates of return. The Commission notes that this requirement may be satisfied by disclosing the ranges of returns for accounts closed with positive net lifetime rates of return and those closed with negative net lifetime rates of return, as the Commission proposed, or by another method, such as standard deviation, that meets the objective.

The Commission indicated in the Performance Proposal that both the numbers of accounts closed with positive versus negative rates of return, as well as the measure of variability of returns for accounts in each category, must be disclosed only for those accounts that both opened and closed within the required five-year and year-to-date time period. One commenter noted that this change from the prior rule, which required information on all accounts that closed

during the required time period even if they were opened more than five years earlier, may result in a reduction in useful information. As it noted in the Performance Proposal, the Commission does not believe that this change will diminish the disclosure of material information to prospective clients, because of the tendency of clients to quickly close accounts that experience large losses. Accounts that experienced strongly negative returns before the five-year time period are likely to have been closed before the end of that time period, and losses experienced as a result of the offered program during the five-year period are likely to have been experienced by an account that both opened and closed during that period. The Commission wishes to make clear that any additional information that the CTA believes is necessary to explain the circumstances affecting the measure of the variability of returns presented in the performance capsule may be provided, pursuant to existing rules regarding supplemental disclosures and material information.⁶⁰

B. Use of Composite Draw-down

Although the Commission is not adopting the proposed revision to Rules 4.35(a)(1)(v) and (vi) which would have required that the worst monthly and peak-to-valley draw-down amounts be based on the aggregate of nominal account sizes, based on the comments received, the Commission believes it is necessary to clarify the issue of presenting draw-down information on the composite of accounts, rather than on the worst individual account.

Rule 4.10(k) defines the term “Draw-down” as “losses experienced by a pool or account over a specified period.” Rule 4.10(l) defines the term “Worst peak-to-valley draw-down” for a pool, account or trading program. In the adopting release for the most recent revisions to the

⁶⁰ See Rules 4.34(n) and 4.34(o).

Part 4 rules, the Commission noted that “the draw-down figures in a composite in a CTA Disclosure Documents are the worst experienced by any one of the accounts included in the composite” (emphasis added).⁶¹ Several commenters expressed concern that composite draw-down would not provide sufficient information as to how bad things might have been for individual accounts. However, other commenters noted that performance of a single account may be misleading due to factors beyond the CTA’s control, such as the client’s determination of when to open or close the account. Another commenter stated that the purpose of draw-down disclosure in performance capsules is to highlight the historical risk and volatility of a particular trading program, not the general risk of futures trading, which is adequately addressed by other rules.

As noted in the Performance Proposal, a variety of factors, including, but not limited to, differences due to trade execution, fees, commissions, and the timing of opening or closing accounts, may have an impact on the returns for individual accounts. The effect of these factors must be considered by the CTA in the development of its composite performance tables and any material differences among the accounts in the composite must be discussed.⁶² The Commission

⁶¹ 60 FR 38146, 38163 (July 25, 1995).

⁶² Rule 4.35(a)(3) states:

- (i) Unless such presentation would be misleading, the performance of accounts traded pursuant to the same trading program may be presented in composite form on a program-by-program basis. . . .
- (ii) Accounts that differ materially with respect to rate of return may not be presented in the same composite.
- (iii) The commodity trading advisor must discuss all material differences among the accounts included in a composite.

continues to believe that for a performance table that complies with the Commission's rules on use of composites, disclosure of draw-down information on a composite basis would not be misleading. The Commission therefore confirms that presentation of monthly and peak-to-valley draw-down information on a composite basis for performance tables that comply with Rule 4.35(a)(3) will be acceptable. CTAs remain subject to the requirement of Rule 4.34(o) to disclose all material information to existing or prospective clients even if such information is not specifically required by these regulations.

C. Treatment of Additions and Withdrawals in Computing Rate of Return

The changes to the rate of return computation in the Performance Proposal would have codified, in a streamlined fashion, several methods of accounting for additions and withdrawals in computing rate of return that were permitted by the Commission's 1991 Advisory.⁶³ In addition to the method currently required by Rule 4.35(a)(6)(i)(F), these methods would include daily compounding and time-weighting of additions and withdrawals. However, the Only Accounts Traded Method, which had been permitted by the 1991 Advisory, was not included as an option CTAs could choose prospectively due to concerns that it allows for accounts to be excluded entirely from the rate of return calculation. One commenter noted that CTAs can reach the same result as the proposed daily compounded rate of return when the calculation is compounded based on each sub-period in which an addition or withdrawal is made. Two

⁶³ "Adjustments for Additions and Withdrawals to Computation of Rate of Return in Performance Records of Commodity Pool Operators and Commodity Trading Advisors," 56 FR 8109 (Feb. 27, 1991). Rule 4.35(a)(6) states that performance information may be calculated as specified therein "or by a method otherwise approved by the Commission."

commenters requested that CTAs continue to be permitted to exclude from the return calculation accounts that opened or closed intramonth, to avoid material distortions that can occur.

Although the Commission adopted a core principle for partially funded account performance and therefore did not implement the proposed changes to the rate of return calculation, based on the comments received on the Performance Proposal, the Commission believes it is appropriate to provide guidance regarding the treatment of additions and withdrawals in computing rate of return.

D. New Appendix B to Part 4

New Appendix B to Part 4 provides guidance concerning alternate methods by which CPOs and CTAs may calculate the rate of return information required by Rules 4.25(a)(7)(i)(F) and 4.35(a)(6)(i)(F). Performance computed in accordance with any of the alternative methods described in the 1991 Advisory for periods prior to the effective date of these rule changes would not need to be revised. However, the 1991 Advisory is superseded prospectively by Appendix B adopted herein.

IV. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA)⁶⁴ requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The Commission has previously established certain definitions of “small entities” to be used by the Commission in evaluating the

⁶⁴ 5 U.S.C. 601 et seq.

impact of its rules on such entities in accordance with the RFA.⁶⁵ With respect to CPOs, the Commission has previously determined that a CPO is a small entity if it meets the criteria for exemption from registration under current Rule 4.13(a)(2).⁶⁶ Therefore, the requirements of the RFA do not apply to CPOs who do not meet those criteria. With respect to CTAs, the Commission has previously stated that it would evaluate within the context of a particular rule proposal whether all or some affected CTAs would be considered to be small entities and, if so, the economic impact on them of the proposal.⁶⁷ The Commission believes that the rules it is adopting today will not place any burdens, whether new or additional, on CPOs and CTAs who would be affected hereunder. This is because these rules provide registration relief for more CPOs and CTAs and, for CPOs and CTAs who are not eligible for that relief, they reduce, clarify, streamline and simplify existing requirements.

The Commission's definitions of small entities do not address the persons and qualifying entities set forth in Rule 4.5 because, by the very nature of the rule, the operations and activities of such persons and entities generally are regulated by federal and state authorities other than the Commission. Assuming, arguendo, that Rule 4.5 eligible persons or qualifying entities would be small entities for purposes of the RFA, the Commission believes that the amendment to Rule 4.5 it is adopting today will not have a significant economic impact on them because it will permit greater operational flexibility for persons currently claiming relief under the rule, and it will

⁶⁵ 47 FR 18618 (April 30, 1982).

⁶⁶ Id. at 18619-20.

⁶⁷ Id. at 18620.

make relief under the rule available to more persons (each of whom will only have to file a notice to be relieved from the requirement to register as a CPO and from the disclosure, reporting and recordkeeping requirements applicable to registered CPOs).

The Commission did not receive any comments on its analysis of the application of the RFA to the instant Part 4 rule amendments.

B. Paperwork Reduction Act

This rulemaking contains information collection requirements. As required by the Paperwork Reduction Act of 1995,⁶⁸ the Commission has submitted a copy of these amendments to Part 4 to the Office of Management and Budget for its review. The Commission did not receive any public comments relative to its analysis of paperwork burdens associated with this rulemaking.

C. Cost-Benefit Analysis

Section 15(a) of the Act, as amended by Section 119 of the CFMA, requires the Commission to consider the costs and benefits of its action before issuing a new regulation under the Act. By its terms, Section 15(a) does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the proposed regulation outweigh its costs. Rather, Section 15(a) simply requires the Commission to “consider the costs and benefits” of its action.

Section 15(a) further specifies that costs and benefits shall be evaluated in light of five broad areas of market and public concern: protection of market participants and the public; efficiency, competitiveness, and financial integrity of futures markets; price discovery; sound

⁶⁸ 44 U.S.C. 3507(d).

risk management practices; and other public interest considerations. Accordingly, the Commission could in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

These amendments to the Part 4 rules are intended to facilitate increased flexibility and consistency, and to rationalize application of Commission regulations to entities subject to other regulatory frameworks. The Commission is considering the costs and benefits of these rules in light of the specific provisions of Section 15(a) of the Act:

1. Protection of market participants and the public. While certain of the amendments are expected to lessen the burden imposed upon CPOs and CTAs, any exclusion or exemption of persons from regulatory requirements are based on such factors as financial sophistication of pool participants and advisory clients or a limited level of trading in the commodity interest markets. Accordingly, the amendments should have no effect on the Commission's ability to protect market participants and the public. Also, there should be no decrease in the protection of market participants and the public where the amendments relax existing requirements under the Act and the Commission's rules in order to be consistent with existing requirements under the federal securities laws and the SEC's rules.

2. Efficiency and competition. The amendments are expected to benefit efficiency and competition by removing barriers to participation in the commodity interest markets, resulting in greater liquidity and market efficiency.

3. Financial integrity of futures markets and price discovery. The amendments should have no effect, from the standpoint of imposing costs or creating benefits, on the financial integrity or price discovery function of the commodity futures and options markets.

4. Sound risk management practices. The proposed amendments should increase the available range of risk management alternatives for Rule 4.5 eligible persons, as well as for CPOs and CTAs.

5. Other public interest considerations. The amendments also take into account certain effects of legislative changes (e.g., in the case of exemption for registered investment advisers) and the passage of time (e.g., revising the contribution limit for the small commodity pool exemption and permitting electronic delivery of pool Annual Reports and Account Statements).

After considering these factors, the Commission has determined to adopt the Part 4 rule amendments discussed above. The Commission did not receive any comments relative to its analysis of the cost-benefit provision.

D. Administrative Procedure Act

The Administrative Procedure Act provides that the required publication of a substantive rule shall be made not less than 30 days before its effective date, but provides an exception for “a substantive rule which grants or recognizes an exemption or relieves a restriction.” Each of the amendments to Rules 4.5, 4.7, 4.12, 4.13, 4.14, 4.21, 4.22 and 4.31 the Commission is publishing today “grants or recognizes an exemption or relieves a restriction.” Accordingly, the Commission has determined to make the amendments to Rules 4.5, 4.7, 4.12, 4.13, 4.14, 4.21, 4.22 and 4.31 effective immediately.

List of Subjects in 17 CFR Part 4

Advertising, Commodity pool operators, Commodity trading advisors, Commodity futures, Commodity options, Customer protection, Reporting and Recordkeeping

For the reasons presented above, the Commission hereby amends Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

1. The authority citation for part 4 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6(c), 6b, 6c, , 6l, 6m, 6n, 6o, 12a and 23.

2. Rule 4.5 is amended by:

- a. deleting paragraph (c)(2)(i);
- b. deleting paragraph (c)(2)(ii);
- c. redesignating paragraph (c)(2)(iii) as paragraph (c)(2)(i) and revising it as so redesignated;
- d. redesignating paragraph (c)(2)(iv) as paragraph (c)(2)(ii);
- e. revising paragraph (f)(2); and
- f. adding new paragraph (g), to read as follows:

§4.5 Exclusion from the definition of the term “commodity pool operator.”

* * * * *

(c) * * *

(2) * * *

- (i) Will disclose in writing to each participant, whether existing or prospective, that the qualifying entity is operated by a person who has claimed an exclusion from the definition of the

term “commodity pool operator” under the Act and, therefore, who is not subject to registration or regulation as a pool operator under the Act; Provided, that such disclosure is made in accordance with the requirements of any other federal or state regulatory authority to which the qualifying entity is subject; and

* * * * *

(f) * * *

(2) Manually signed by a representative duly authorized to bind a person specified in paragraph (a) of this section; and

* * * * *

(g) The filing of a notice of eligibility or the application of “non-pool status” under this section will not affect the ability of a person to qualify for an exemption from registration as a commodity pool operator under §4.13 in connection with the operation of another trading vehicle that is not covered under this §4.5.

3. Section 4.7 is amended by revising paragraphs (a)(2)(vi), (a)(3)(viii) and (d)(1)(vii), to read as follows:

§4.7 Exemption from certain part 4 requirements for commodity pool operators with respect to offerings to qualified eligible persons and for commodity trading advisors with respect to advising qualified eligible persons.

(a) * * *

(2) * * *

(vi) A “qualified purchaser” as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 (the “Investment Company Act”);

* * * * *

(3) * * *

(viii) A corporation, Massachusetts or similar business trust, or partnership, limited liability company or similar business venture, other than a pool, which has total assets in excess of \$5,000,000, and is not formed for the specific purpose of either participating in the exempt pool or opening an exempt account;

* * * * *

(d)* * *

(1)* * *

(vii) Be manually signed by a representative duly authorized to bind the commodity pool operator or commodity trading advisor;

* * * * *

4. Section 4.12 is amended by revising paragraph (b)(3)(vi) to read as follows:

§4.12 Exemption from provisions of part 4.

* * * * *

(b)* * *

(3)* * *

(vi) Be manually signed by a representative duly authorized to bind the pool operator;
and

* * * * *

5. Section 4.13 is amended by:

a. adding introductory text;

- b. deleting the “or” at the end of paragraph (a)(1)(iv);
- c. revising paragraph (a)(2);
- d. adding new paragraphs (a)(3), (a)(4) and (a)(5);
- e. revising paragraph (b);
- f. redesignating paragraph (c) as paragraph (d) and revising it as so redesignated;
- g. adding new paragraph (c);
- h. redesignating paragraph (d) as paragraph (e) and revising it as so redesignated; and
- i. adding new paragraph (f), to read as follows:

§4.13 Exemption from registration as a commodity pool operator.

This section is organized as follows: Paragraph (a) specifies the criteria that must be met to qualify for exemption from registration under this section; paragraph (b) governs the notice that must be filed to claim exemption from registration; paragraph (c) sets forth the continuing obligations of a person who has claimed exemption under this section; paragraph (d) specifies information certain persons must provide if they subsequently register; and paragraph (e) specifies the effect of registration on a person who has claimed an exemption from registration under this section or who is eligible to claim an exemption from registration hereunder.

(a)* * *

(1)* * *

(iv) Neither the person nor any other person involved with the pool does any advertising in connection with the pool (for purposes of this section, advertising includes the systematic solicitation of prospective participants by telephone or seminar presentation);

(2)(i) None of the pools operated by it has more than 15 participants at any time; and

(ii) The total gross capital contributions it receives for units of participation in all of the pools it operates or that it intends to operate do not in the aggregate exceed \$400,000.

(iii) For the purpose of determining eligibility for exemption under paragraph (a)(2) of this section, the person may exclude the following participants and their contributions:

(A) The pool's operator, commodity trading advisor, and the principals thereof;

(B) A child, sibling or parent of any of these participants;

(C) The spouse of any participant specified in paragraph (a)(2)(iii)(A) or (B) of this section; and

(D) Any relative of a participant specified in paragraph (a)(2)(iii)(A), (B) or (C) of this section, its spouse or a relative of its spouse, who has the same principal residence as such participant;

(3) For each pool for which the person claims exemption from registration under this paragraph (a)(3):

(i) Interests in the pool are exempt from registration under the Securities Act of 1933, and such interests are offered and sold without marketing to the public in the United States;

(ii) At all times, the pool meets one or the other of the following tests with respect to its commodity interest positions, including positions in security futures products, whether entered into for bona fide hedging purposes or otherwise:

(A) The aggregate initial margin and premiums required to establish such positions, determined at the time the most recent position was established, will not exceed 5 percent of the liquidation value of the pool's portfolio, after taking into account unrealized profits and

unrealized losses on any such positions it has entered into; Provided, That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in §190.01(x) of this chapter may be excluded in computing such 5 percent; or

(B) The aggregate net notional value of such positions, determined at the time the most recent position was established, does not exceed 100 percent of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into. For the purpose of this paragraph:

(1) The term "notional value" shall be calculated for each such futures position by multiplying the number of contracts by the size of the contract, in contract units (taking into account any multiplier specified in the contract), by the current market price per unit, and for each such option position by multiplying the number of contracts by the size of the contract, adjusted by its delta, in contract units (taking into account any multiplier specified in the contract), by the strike price per unit; and

(2) The person may net contracts with the same underlying commodity across designated contract markets, registered derivatives transaction execution facilities and foreign boards of trade; and

(iii) The person reasonably believes, at the time of investment (or, in the case of an existing pool, at the time of conversion to a pool meeting the criteria of paragraph (a)(3) of this section), that each person who participates in the pool is:

(A) An "accredited investor," as that term is defined in §230.501 of this title;

(B) A trust that is not an accredited investor but that was formed by an accredited investor for the benefit of a family member;

(C) A “knowledgeable employee,” as that term is defined in §270.3c-5 of this title; or

(D) A “qualified eligible person,” as that term is defined in §4.7(a)(2)(viii)(A) of this chapter; and

(iv) Participations in the pool are not marketed as or in a vehicle for trading in the commodity futures or commodity options markets; Provided, That nothing in paragraph (a)(3) of this section shall prohibit the person from claiming an exemption under this section if it additionally operates one or more pools for which it meets the criteria of paragraph (a)(4) of this section; or

(4) For each pool for which the person claims exemption from registration under this paragraph (a)(4):

(i) Interests in the pool are exempt from registration under the Securities Act of 1933, and such interests are offered and sold without marketing to the public in the United States;

(ii) The person reasonably believes, at the time of investment (or, in the case of an existing pool, at the time of conversion to a pool meeting the criteria of paragraph (a)(4) of this section), that:

(A) Each natural person participant (including such person’s self-directed employee benefit plan, if any), is a “qualified eligible person,” as that term is defined in §4.7(a)(2); and

(B) Each non-natural person participant is a “qualified eligible person,” as that term is defined in §4.7, or an “accredited investor,” as that term is defined in §230.501(a)(1)-(3), (a)(7) and (a)(8) of this title; Provided, That nothing in paragraph (a)(4) of this section will prohibit the person from claiming an exemption under this section if it additionally operates one or more pools that meet the criteria of paragraph (a)(3) of this section.

(5)(i) Eligibility for exemption under this section is subject to the person furnishing in writing to each prospective participant in the pool:

(A) A statement that the person is exempt from registration with the Commission as a commodity pool operator and that therefore, unlike a registered commodity pool operator, it is not required to deliver a Disclosure Document and a certified annual report to participants in the pool; and

(B) A description of the criteria pursuant to which it qualifies for such exemption from registration.

(ii) The person must make these disclosures by no later than the time it delivers a subscription agreement for the pool to a prospective participant in the pool.

(b)(1) Any person who desires to claim the relief from registration provided by this section must file a notice of exemption from commodity pool operator registration with the National Futures Association (ATTN: Director of Compliance). The notice must:

(i) Provide the name, main business address, main business telephone number, main facsimile number and main email address of the person claiming the exemption and the name of the pool for which it is claiming exemption;

(ii) Contain the section number pursuant to which the operator is filing the notice (i.e., §4.13(a)(1), (a)(2), (a)(3), or (a)(4), or both (a)(3) and (a)(4)) and represent that the pool will be operated in accordance with the criteria of that paragraph or paragraphs; and

(iii) Be manually signed by a representative duly authorized to bind the person.

(2) The person must file the notice by no later than the time it delivers a subscription agreement for the pool to a prospective participant in the pool; Provided, That where a person

registered with the Commission as a commodity pool operator intends to withdraw from registration in order to claim exemption hereunder, the person must notify its pool's participants in writing that it intends to withdraw from registration and claim the exemption, and it must provide each such participant with a right to redeem its interest in the pool prior to the person filing a notice of exemption from registration.

(3) The notice will be effective upon filing, provided the notice is materially complete.

(4) Each person who has filed a notice of exemption from registration under this section must, in the event that any of the information contained or representations made in the notice becomes inaccurate or incomplete, file a supplemental notice with the National Futures Association to that effect which, if applicable, includes such amendments as may be necessary to render the notice accurate and complete. This supplemental notice must be filed within 15 business days after the pool operator becomes aware of the occurrence of such event.

(c)(1) Each person who has filed a notice of exemption from registration under this section must:

(i) Make and keep all books and records prepared in connection with its activities as a pool operator for a period of five years from the date of preparation;

(ii) Keep such books and records readily accessible during the first two years of the five-year period. All such books and records must be available for inspection upon the request of any representative of the Commission, the United States Department of Justice, or any other appropriate regulatory agency; and

(iii) Submit to such special calls as the Commission may make to demonstrate eligibility for and compliance with the applicable criteria for exemption under this section.

(2) In the event the person distributes an annual report to participants in the pool for which it has filed the notice, the annual report must be presented and computed in accordance with generally accepted accounting principles consistently applied and, if certified by an independent public accountant, so certified in accordance with §1.16 of this chapter as applicable.

(3) Each person who has filed a notice of exemption from registration pursuant to paragraph (a)(1) or (a)(2) of this section must:

(i) Promptly furnish to each participant in the pool a copy of each monthly statement for the pool that the pool operator received from a futures commission merchant pursuant to §1.33 of this chapter; and

(ii) Clearly show on such statement, or on an accompanying supplemental statement, the net profit or loss on all commodity interests closed since the date of the previous statement.

(d) Each person who applies for registration as a commodity pool operator subsequent to claiming relief under paragraph (a)(1) or (a)(2) of this section must include with its application the financial statements and other information required by §4.22(c)(1) through (5) for each pool that it has operated as an operator exempt from registration. That information must be presented and computed in accordance with generally accepted accounting principles consistently applied. If the person is granted registration as a commodity pool operator, it must comply with the provisions of this part with respect to each such pool.

(e)(1) Subject to the provisions of paragraph (e)(2) of this section, if a person who is eligible for exemption from registration as a commodity pool operator under this section nonetheless registers as a commodity pool operator, the person must comply with the provisions

of this part with respect to each commodity pool identified on its registration application or supplement thereto.

(2) If a person operates one or more commodity pools described in paragraph (a)(3) or (a)(4) of this section, and one or more commodity pools for which it must be, and is, registered as a commodity pool operator, the person is exempt from the requirements applicable to a registered commodity pool operator with respect to the pool or pools described in paragraph (a)(3) or (a)(4) of this section; Provided, That the person:

(i) Furnishes in writing to each prospective participant in a pool described in paragraph (a)(3) or (a)(4) of this section that it operates:

(A) A statement that it will operate the pool as if the person was exempt from registration as a commodity pool operator;

(B) A description of the criteria pursuant to which it will so operate the pool; and

(ii) Complies with paragraph (c) of this section.

(f) The filing of a notice of exemption from registration under this section will not affect the ability of a person to qualify for exclusion from the definition of the term “commodity pool operator” under §4.5 in connection with its operation of another trading vehicle that is not covered under this §4.13.

6. Section 4.14 is amended by:

a. adding introductory text;

b. revising paragraph (a)(8);

c. removing the period and adding a semi-colon followed by the word “or” at the end of paragraph (a)(9);

- d. adding new paragraph (a)(10); and
- e. revising paragraph (c), to read as follows:

§4.14 Exemption from registration as a commodity trading advisor.

This section is organized as follows: Paragraph (a) specifies the criteria that must be met to qualify for exemption from registration under this section, including the notice of exemption from registration and continuing obligations of persons who have claimed exemption under paragraph (a)(8) of this section; paragraph (b) concerns “cash market transactions”; and paragraph (c) specifies the effect of registration on a person who has claimed an exemption from registration under this section or who is eligible to claim an exemption from registration hereunder.

(a)* * *

(8) It is registered as an investment adviser under the Investment Advisers Act of 1940 or with the applicable securities regulatory agency of any State, or it is exempt from such registration, or it is excluded from the definition of the term “investment adviser” pursuant to the provisions of sections 202(a)(2) and 202(a)(11) of the Investment Advisers Act of 1940,

Provided, That:

(i) The person’s commodity interest trading advice is directed solely to, and for the sole use of, one or more of the following:

(A) “Qualifying entities,” as that term is defined in §4.5(b), for which a notice of eligibility has been filed;

(B) Collective investment vehicles that are excluded from the definition of the term commodity “pool” under §4.5(a)(4); and

(C) Commodity pools that are organized and operated outside of the United States, its territories or possessions, where:

(1) The commodity pool operator of each such pool has not so organized and is not so operating the pool for the purpose of avoiding commodity pool operator registration;

(2) With the exception of the pool's operator, advisor and their principals, solely "Non-United States persons," as that term is defined in §4.7(a)(1)(iv), will contribute funds or other capital to, and will own beneficial interests in, the pool; Provided, That units of participation in the pool held by persons who do not qualify as Non-United States persons or otherwise as qualified eligible persons represent in the aggregate less than 10 percent of the beneficial interest of the pool;

(3) No person affiliated with the pool conducts any marketing activity for the purpose of, or that could reasonably have the effect of, soliciting participation from other than Non-United States persons; and

(4) No person affiliated with the pool conducts any marketing activity from within the United States, its territories or possessions; and

(D) A commodity pool operator who has claimed an exemption from registration under §4.13(a)(3) or 4.13(a)(4), or, if registered as a commodity pool operator, who may treat each pool it operates that meets the criteria of §4.13(a)(3) or 4.13(a)(4) as if it were not so registered;

(ii) The person:

(A) Provides commodity interest trading advice solely incidental to its business of providing securities or other investment advice to qualifying entities, collective investment vehicles and commodity pools as described in paragraph (a)(8)(i) of this section; and

(B) Is not otherwise holding itself out as a commodity trading advisor.

(iii)(A) A person who desires to claim the relief from registration provided by this §4.14(a)(8) must file a notice of exemption from commodity trading advisor registration with the National Futures Association (ATTN: Director of Compliance). The notice must:

(1) Provide the name, main business address, main business telephone number, main facsimile number and main email address of the trading advisor claiming the exemption;

(2) Contain the section number pursuant to which the advisor is filing the notice (i.e., §4.14(a)(8)(i) or (a)(8)(ii), or both (a)(8)(i) and (a)(8)(ii)) and represent that it will provide commodity interest advice to its clients in accordance with the criteria of that paragraph or paragraphs; and

(3) Be manually signed by a representative duly authorized to bind the person.

(B) The person must file the notice by no later than the time it delivers an advisory agreement for the trading program pursuant to which it will offer commodity interest advice to a client; Provided, That where the advisor is registered with the Commission as a commodity trading advisor, it must notify its clients in writing that it intends to withdraw from registration and claim the exemption and must provide each such client with a right to terminate its advisory agreement prior to the person filing a notice of exemption from registration.

(C) The notice will be effective upon filing, provided the notice is materially complete.

(D) Each person who has filed a notice of registration exemption under this section must, in the event that any of the information contained or representations made in the notice becomes inaccurate or incomplete, file a supplemental notice with the National Futures Association to that effect which, if applicable, includes such amendments as may be necessary to

render the notice accurate and complete. This supplemental notice must be filed within 15 business days after the trading advisor becomes aware of the occurrence of such event.

(iv) Each person who has filed a notice of registration exemption under this §4.14 (a)(8) must:

(A)(1) Make and keep all books and records prepared in connection with its activities as a trading advisor, including all books and records demonstrating eligibility for and compliance with the applicable criteria for exemption under this section, for a period of five years from the date of preparation; and

(2) Keep such books and records readily accessible during the first two years of the five-year period. All such books and records must be available for inspection upon the request of any representative of the Commission, the United States Department of Justice, or any other appropriate regulatory agency; and

(B) Submit to such special calls as the Commission may make to demonstrate eligibility for and compliance with the applicable criteria for exemption under this section;

(9)* * *

(ii) Providing commodity trading advice based on, or tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients; or

(10) If, as provided for in section 4m(1) of the Act, during the course of the preceding 12 months, it has not furnished commodity trading advice to more than 15 persons and it does not hold itself out generally to the public as a commodity trading advisor.

(i) For the purpose of paragraph (a)(10) of this section, the following are deemed a single person:

- (A) A natural person, and:
- (1) Any minor child of the natural person;
- (2) Any relative, spouse, or relative of the spouse of the natural person who has the same principal residence;
- (3) All accounts of which the natural person and/or the persons referred to in paragraph (a)(10)(i)(A) of this section are the only primary beneficiaries; and
- (4) All trusts of which the natural person and/or the persons referred to in paragraph (a)(10)(i)(A) of this section are the only primary beneficiaries;
- (B)(1) A corporation, general partnership, limited partnership, limited liability company, trust (other than a trust referred to in paragraph (a)(10)(i)(A)(4) of this section), or other legal organization (any of which are referred to hereinafter as a “legal organization”) that receives commodity interest trading advice based on its investment objectives rather than the individual investment objectives of its shareholders, partners, limited partners, members, or beneficiaries (any of which are referred to hereinafter as an “owner”); and
- (2) Two or more legal organizations referred to in paragraph (a)(10)(i)(B)(1) of this section that have identical owners.
- (ii) Special Rules. For the purpose of paragraph (a)(10) of this section:
- (A) An owner must be counted in its own capacity as a person if the commodity trading advisor provides advisory services to the owner separate and apart from the advisory services provided to the legal organization; Provided, That the determination that an owner is a client will not affect the applicability of paragraph (a)(10) of this section with regard to any other owner;

(B)(1) A general partner of a limited partnership, or other person acting as a commodity trading advisor to the partnership, may count the limited partnership as one person; and

(2) A manager or managing member of a limited liability company, or any other person acting as a commodity trading advisor to the company, may count the limited liability company as one person.

(C) A commodity trading advisor that has its principal office and place of business outside of the United States, its territories or possessions must count only clients that are residents of the United States, its territories and possessions; a commodity trading advisor that has its principal office and place of business in the United States or in any territory or possession thereof must count all clients.

(iii) Holding Out. Any commodity trading advisor relying on paragraph (a)(10) of this section shall not be deemed to be holding itself out generally to the public as a commodity trading advisor, within the meaning of section 4m(1) of the Act, solely because it participates in a non-public offering of interests in a collective investment vehicle under the Securities Act of 1933.

* * * * *

(c)(1) Subject to the provisions of paragraph (c)(2) of this section, if a person who is eligible for exemption from registration as a commodity trading advisor under this section nonetheless registers as a commodity trading advisor, the person must comply with the provisions of this part with respect to those clients for which it could have claimed an exemption from registration hereunder.

(2) If a person provides commodity interest trading advice to a client described in paragraph (a) of this section and to a client for which it must be, and is, registered as a commodity trading advisor, the person is exempt from the requirements applicable to a registered commodity trading advisor with respect to the clients so described; Provided, That the person furnishes in writing to each prospective client described in paragraph (a) of this section a statement that it will provide commodity interest trading advice to the client as if it was exempt from registration as a commodity trading advisor.

7. Section 4.21 is amended by revising paragraph (a) to read as follows:

§4.21 Required delivery of pool Disclosure Document.

(a)(1) Subject to the provisions of paragraph (a)(2) of this section, each commodity pool operator registered or required to be registered under the Act must deliver or cause to be delivered to a prospective participant in a pool that it operates or intends to operate a Disclosure Document for the pool prepared in accordance with §§4.24 and 4.25 by no later than the time it delivers to the prospective participant a subscription agreement for the pool; Provided, That any information distributed in advance of the delivery of the Disclosure Document to a prospective participant is consistent with or amended by the information contained in the Disclosure Document and with the obligations of the commodity pool operator under the Act, the Commission's regulations issued thereunder, and the laws of any other applicable federal or state authority; Provided, further, That in the event such previously distributed information is amended by the Disclosure Document in any material respect, the prospective participant must be in receipt of the Disclosure Document at least 48 hours prior to its subscription being accepted by the pool operator.

(2) For the purpose of the Disclosure Document delivery requirement, including any offering memorandum delivered pursuant to §4.7(b)(1) or 4.12(b)(2)(i), the term “prospective pool participant” does not include a commodity pool operated by a pool operator that is the same as, or that controls, is controlled by, or is under common control with, the pool operator of the offered pool.

* * * * *

8. Section 4.22 is amended by:
 - a. revising paragraph (a) introductory text;
 - b. adding new paragraph (a)(4),
 - c. revising paragraph (c) introductory text,
 - d. adding a new paragraph (c)(6),
 - e. revising paragraph (h)(1),
 - f. revising paragraph (h)(3),
 - g. adding new paragraph (i) and
 - h. adding new paragraph (j), to read as follows:

§4.22 Reporting to pool participants.

(a) Except as provided in paragraph (a)(4) of this section, each commodity pool operator registered or required to be registered under the Act must periodically distribute to each participant in each pool that it operates, within 30 calendar days after the last date of the reporting period prescribed in paragraph (b) of this section, an Account Statement, which shall be presented in the form of a Statement of Income (Loss) and a Statement of Changes in Net Asset Value, for the prescribed period. These financial statements must be presented and

computed in accordance with generally accepted accounting principles consistently applied. The Account Statement must be signed in accordance with paragraph (h) of this section.

* * * * *

(4) For the purpose of the Account Statement delivery requirement, including any Account Statement distributed pursuant to §4.7(b)(2) or 4.12(b)(2)(ii), the term “participant” does not include a commodity pool operated by a pool operator that is the same as, or that controls, is controlled by, or is under common control with, the pool operator of a pool in which the commodity pool has invested.

* * * * *

(c) Except as provided in paragraph (c)(6) of this section, each commodity pool operator registered or required to be registered under the Act must distribute an Annual Report to each participant in each pool that it operates, and must file a copy of the Report with the National Futures Association, within 90 calendar days after the end on the pool’s fiscal year or the permanent cessation of trading, whichever is earlier, but in no event longer than 90 days after funds are returned to pool participants; Provided, however, That if during any calendar year the commodity pool operator did not operate a commodity pool, the pool operator must so notify the National Futures Association within 30 calendar days after the end of such calendar year. The Annual Report must be signed pursuant to paragraph (h) of this section and must contain the following:

* * * * *

(6) For the purpose of the Annual Report distribution requirement, including any annual report distributed pursuant to §4.7(b)(3) or 4.12(b)(2)(iii), the term “participant” does not include

a commodity pool operated by a pool operator that is the same as, or that controls, is controlled by, or is under common control with, the pool operator of a pool in which the commodity pool has invested; Provided, That the Annual Report of such investing pool contain financial statements that include such information as the Commission may specify concerning the operations of the pool in which the commodity pool has invested.

* * * * *

(h)(1) Each Account Statement and Annual Report, including an Account Statement or Annual Report provided pursuant to §4.7(b) or 4.12(b), must contain an oath or affirmation that, to the best of the knowledge and belief of the individual making the oath or affirmation, the information contained in the document is accurate and complete; Provided, however, That it shall be unlawful for the individual to make such oath or affirmation if the individual knows or should know that any of the information in the document is not accurate and complete.

* * * * *

(3) Subject to the provisions of paragraph (j) of this section, the oath or affirmation must be manually signed by a representative duly authorized to bind the pool operator.

(i) The Account Statement or Annual Report may be distributed to a pool participant by means of electronic media if the participant so consents; Provided, That prior to the transmission of any Account Statement or Annual Report by means of electronic media, a commodity pool operator must disclose to the participant that it intends to distribute electronically the Account Statement or Annual Report or both documents, as the case may be, absent objection from the participant, which objection, if any, the participant must make no later than 10 business days following its receipt of the disclosure.

(j) An Account Statement or Annual Report may contain a facsimile signature, Provided,

That:

(A) The CPO maintains in accordance with §4.23 the Account Statement or Annual Report containing the manual signature from which the facsimile signature was made; and

(B) The Annual Report the CPO files with a registered futures association is manually signed.

(ii) For each pool for which the CPO distributes an Account Statement or Annual Report by means of electronic media, the CPO must make and keep in accordance with §4.23 a manually signed copy of the Statement.

9. Section 4.31 is amended by revising paragraph (a) to read as follows:

§4.31 Required delivery of Disclosure Document to prospective clients.

(a) Each commodity trading advisor registered or required to be registered under the Act must deliver or cause to be delivered to a prospective client a Disclosure Document containing the information set forth in §§4.34 and 4.35 for the trading program pursuant to which the trading advisor seeks to direct the client's commodity interest account or to direct the client's commodity interest trading by means of a systematic program that recommends specific transactions by no later than the time the trading advisor delivers to the prospective client an advisory agreement to direct or guide the client's account; Provided, That any information distributed in advance of the delivery of the Disclosure Document to a prospective client is consistent with or amended by the information contained in the Disclosure Document and with the obligations of the commodity trading advisor under the Act, the Commission's regulations issued thereunder, and the laws of any other applicable federal or state authority; Provided

further, That in the event such previously distributed information is amended by the Disclosure Document in any material respect, the prospective participant must be in receipt of the Disclosure Document at least 48 hours prior to the advisory agreement being accepted by the trading advisor.

* * * * *

10. Section 4.35 is amended by revising paragraph (a)(1)(viii) to read as follows:

§4.35 Performance disclosures.

(a) *General principles.* – (1) * * *

(viii) In the case of the offered trading program:

(A) (1) The number of accounts traded pursuant to the offered trading program that were opened and closed during the period specified in §4.35(a)(5) with a positive net lifetime rate of return as of the date the account was closed; and

(2) A measure of the variability of returns for accounts that were both opened and closed during the period specified in §4.35(a)(5) and closed with positive net lifetime rates of return; and

(B) (1) The number of accounts traded pursuant to the offered trading program that were opened and closed during the period specified in §4.35(a)(5) with negative net lifetime rates of return as of the date the account was closed; and

(2) A measure of the variability of returns for accounts that were both opened and closed during the period specified in §4.35(a)(5) and closed with negative net lifetime rates of return.

(C) The measure of variability required by §§4.35(a)(1)(viii)(A)(2) and (B)(2) may be provided as a range of both positive and negative net lifetime returns, or by any other form of

disclosure that meets the objective of disclosure of the variability of returns experienced by clients in the trading program whose accounts were opened and closed during the period specified in §4.35(a)(5). The net lifetime rate of return shall be calculated as the compounded product of the monthly rates of return for each month the account is open.

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APPENDIX A TO PART 4 – GUIDANCE ON THE APPLICATION OF RULE 4.13(a)(3) IN THE FUND-OF-FUNDS CONTEXT

The following provides guidance on the application of the trading limits of Rule 4.13(a)(3)(ii) to commodity pool operators (CPOs) who operate “fund-of-funds.” For the purpose of this Appendix A, it is presumed that the CPO can comply with all of the other requirements of Rule 4.13(a)(3). It also is presumed that where the investor fund CPO is relying on its own computations, the investor fund is participating in each investee fund that trades commodity interests as a passive investor, with limited liability (e.g., as a limited partner of a limited partnership or a non-managing member of a limited liability company). Fund-of-fund CPOs who seek to claim exemption from registration under Rule 4.13(a)(1), (a)(2) or (a)(4) may do so without regard to the trading engaged in by an investee fund, because none of the registration exemptions set forth in those rules concerns limits on or levels of commodity interest trading. Persons whose fact situations do not fit any of the scenarios below should contact Commission staff to discuss the applicability of the registration exemption in Rule 4.13(a)(3) to their particular situations.

1. Situation: An investor fund CPO allocates the fund’s assets to one or more investee funds, none of which meets the trading limits of Rule 4.13(a)(3) and each of which is operated

by a registered CPO. It does not allocate any of the investor fund's assets directly to commodity interest trading.

Application: The investor fund CPO may claim relief under Rule 4.13(a)(3) provided the investor fund itself meets the trading limits of Rule 4.13(a)(3).

2. Situation: An investor fund CPO allocates the fund's assets to one or more investee funds, each having a CPO who is either: (1) itself claiming exemption from CPO registration under Rule 4.13(a)(3); or (2) a registered CPO that is complying with the trading restrictions of Rule 4.13(a)(3). It does not allocate any of the investor fund's assets directly to commodity interest trading.

Application: The investor fund CPO fund may rely upon the representations of the investee fund CPOs that they are complying with the trading limits of Rule 4.13(a)(3).

3. Situation: An investor fund CPO allocates the fund's assets to investee funds, each of which operates under a percentage restriction on the amount of margin or option premiums that may be used to establish its commodity interest positions (whether pursuant to Rule 4.12(b), Rule 4.13(a)(3)(i)(A) or otherwise), by, e.g., contractual agreement. It does not allocate any of the investor fund's assets directly to commodity interest trading.

Application: The CPO of the investor fund may multiply the percentage restriction applicable to each investee fund by the percentage of the investor fund's allocation of assets to that investee fund to determine whether the CPO is operating the investor fund in compliance with Rule 4.13(a)(3)(i)(A).

4. Situation: An investor fund CPO allocates the fund's assets to one or more investee funds, and it has actual knowledge of the trading limits and commodity interest positions of the

investee funds, e.g., where the CPO or one or more affiliates of the CPO operate the investee funds. (For this purpose, an “affiliate” is a person who controls, who is controlled by, or who is under common control with, the CPO.) It does not allocate any of the investor fund’s assets directly to commodity interest trading.

Application: The investor fund CPO may aggregate commodity interest positions across investee funds to determine compliance with the trading restrictions of Rule 4.13(a)(3). For this purpose, the aggregate assets of the investee funds would be compared to the aggregate of their commodity interest positions (as to margin or as tonet notional value). The investor fund CPO should use the results of this computation to determine its compliance with the trading limits of Rule 4.13(a)(3).

5. Situation: An investor fund CPO allocates no more than 50 percent of the fund’s assets to investee funds that trade commodity interests (without regard to the level of commodity interest trading engaged in by those investee pools). It does not allocate any of the investor fund’s assets directly to commodity interest trading.

Application: The investor fund CPO may claim relief under Rule 4.13(a)(3).

6. Situation: An investor fund CPO allocates the fund’s assets to both investee funds and direct trading of commodity interests.

Application: The investor fund CPO must treat the amount of investor fund assets committed to such direct trading as a separate pool for purposes of determining compliance with Rule 4.13(a)(3)(i), such that the commodity interest trading of that pool must meet the criteria of Rule 4.13(a)(3)(i) independently of the portion of investor fund assets allocated to investee funds.

APPENDIX B TO PART 4 — ADJUSTMENTS FOR ADDITIONS AND WITHDRAWALS IN THE COMPUTATION OF RATE OF RETURN

This appendix provides guidance concerning alternate methods by which commodity pool operators and commodity trading advisors may calculate the rate of return information required by Rules 4.25(a)(7)(i)(F) and 4.35(a)(6)(i)(F). The methods described herein are illustrative of calculation methods the Commission has reviewed and determined may be appropriate to address potential material distortions in the computation of rate of return due to additions and withdrawals that occur during a performance reporting period. A commodity pool operator or commodity trading advisor may present to the Commission proposals regarding any alternative method of addressing the effect of additions and withdrawals on the rate of return computation, including documentation supporting the rationale for use of that alternate method.

1. Compounded rate of return method

Rate of return for a period may be calculated by computing the net performance divided by the beginning net asset value for each trading day in the period and compounding each daily rate of return to determine the rate of return for the period. If daily compounding is not practicable, the rate of return may be compounded on the basis of each sub-period within which an addition or withdrawal occurs during a month. For example:

	Account Value	Change in Value
Start of month	\$10,000	+10% (\$1,000 profit)
End of 1st acct. period	\$11,000	\$4,000 addition
Start of 2nd acct. period	\$15,000	-20% (\$3,000 loss)
End of 2nd acct. period	\$12,000	\$2,000 withdrawal
Start of 3rd acct. period	\$10,000	+25% (\$2,500 profit)
End of month	\$12,500	

Compounded ROR = $[(1 + .1)(1 - .2)(1 + .25)] - 1 = 10\%$

2. Time-weighted method

Time-weighting allows for adjustment to the denominator of the rate of return calculation for additions and withdrawals, weighted for the amount of time such funds were available during the period. Several methods exist for time-weighting, all of which will have the same arithmetic result. These methods include: dividing the net performance by the average weighted account sizes for the month; dividing the net performance by the arithmetic mean of the account sizes for each trading day during the period; and taking the number of days funds were available for trading divided by the total number of days in the period.

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Secretary of the Commission